INDEX.

	Page
OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
STATUTES AND RULES INVOLVED	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	6
A. The Decision of the Court of Appeals Permitting Respondent to Assert a Claim for Counsel Fees Against Petitioners Is in Conflict With Applicable Decisions of This Court and Courts of Appeals of Other Circuits and Presents an Important and Far-Reaching Question Which This Court Should Resolve in the Public Interest	6
B. The Court of Appeals' Interpretation of Rule 23 of the Federal Rules of Civil Procedure Is in Conflict With the Decision of Another Court of Appeals, and Is Contrary to the Purpose of the Rule; Its Decision Has So Far Departed From the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision	11
C. The Decision of the Court of Appeals That Plaintiff's Complaint Stated a Cause of Action Under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) Promulgated Thereunder Is in Conflict With Applicable Decisions of the Courts of Appeals of Other Circuits	14
CONCLUSION	16

INDEX (Cont'd)

Page

APPENDIX A:

Statutes and Rules Involved A1

APPENDIX B:

Opinion of the Court of Appeals for the Third Circuit ... A6

Opinion of the Court of Appeals for the Third Circuit Sur Petition for Rehearing A29

APPENDIX C:

Judgment of the Court of Appeals for the Third Circuit .. A30

APPENDIX D:

Opinion of the United States District Court for the District of Delaware A32

TABLE OF CITATIONS.

Cases:	Page
Ballwanz v. Jarka Corporation of Baltimore, 382 F. 2d 433 (4th Cir. 1967)	8
Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (2d Cir. 1951), cert. den., 343 U. S. 956 (1952)	14
Chrysler Corporation v. Dann, 43 Del. Ch. 252, 223 A. 2d 384 (Del. Sup. Ct. 1966)	7, 14
Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U. S. 714 (1967)	7
Globus, Inc. v. Jaroff, 279 F. Supp. 807 (S. D. N. Y. 1968)	14
Greater Iowa Corporation v. McLendon, 378 F. 2d 783 (8th Cir. 1967)	15
Greenstein v. Paul, 400 F. 2d 580 (2d Cir. 1968)	15
Iroquois Industries v. Syracuse China Corp., 417 F. 2d 963 (2d Cir. 1969)	15
Jachimiec v. Schenley Industries, Inc., No. 15027 (7th Cir. 1965), cert. den., 382 U. S. 841 (1965)	15
Jones v. Uris Sales Corporation, 373 F. 2d 644 (2d Cir. 1967)	7
Levine v. Bradlee, 378 F. 2d 620 (3rd Cir. 1967)	7, 14
Mardel Securities Inc. v. Alexandria Gazette Corporation, 278 F. Supp. 1010 (E. D. Va. 1967)	9
Mills v. Electric Auto-Lite Co., 396 U. S. 375 (1970)	6, 7, 9
Missouri Pacific Railroad Co. v. Slayton, 407 F. 2d 1078 (8th Cir. 1969), cert. den., 395 U. S. 937 (1969)	7, 9
Mutual Shares Corporation v. Genesco, 384 F. 2d 540 (2d Cir. 1967)	15
Nolte v. Hudson Nav. Co., 47 F. 2d 166 (2d Cir. 1931)	7
Rogers v. Hill, 34 F. Supp. 358 (S. D. N. Y. 1940)	9
Rosenthal v. Burry Biscuit Corporation, 209 A. 2d 459 (Del. Ch. 1949)	14
SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2d Cir. 1968), cert. den., 394 U. S. 976 (1969)	10
Sprague v. Ticonic National Bank, 307 U. S. 161 (1939)	7
Trustee v. Greenough, 105 U. S. 527 (1882)	6
Wolf v. Barkes, 348 F. 2d 994 (2d Cir. 1965), cert. den., 382 U. S. 941 (1965)	11, 13

TABLE OF CITATIONS (Continued).

Rules: Page

Federal Rules of Civil Procedure:
Rule 23 ..... 2, 5, 10, 11, 12, 13, 14

Statutes: Page

Securities Exchange Act of 1934:
Section 10(b), 15 USC § 78j(b) 2, 4, 5, 14, 15
Rule 10b-5, 17 CFR § 240.10b-5 ..... 2, 4, 5, 14, 15
28 USC § 1254(1) 2

Miscellaneous: Page

New York Stock Exchange Company Manual, Section A-2, p. A-18 10

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No.

GLEN ALDEN CORPORATION, MESHULAM RIKLIS, DOROTHY H. AND LEWIS ROSENSTIEL FOUNDATION, R. G. SMITH, E. R. DEUTSCHE, D. D. BUSCHER, H. S. FELDMAN, SYLVAN OESTREICHER, J. L. MORRIS, THEODORE GOMMI, D. A. CHERNOW, W. E. DEVEREAUX, BERNARD GOLDBERG, G. D. KUHN, L. B. NICHOLS, JOHN MACKIE AND THEODORE C. WIEHE,

Petitioners,

v.

ALEXANDER KAHAN, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioners pray that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Third Circuit entered in this case on February 20, 1970 reversing an order of the United States District Court for the District of Delaware which dismissed the petition for counsel fees brought by respondent.

OPINIONS BELOW.

The Opinions of the Court of Appeals appear in Appendix B and are not yet reported.

The Opinion of the United States District Court appears as Appendix D and is reported at 300 F. Supp. 447 (D. Del. 1969).

JURISDICTION.

The judgment of the Court of Appeals for the Third Circuit sought to be reviewed was entered on February 20, 1970. A petition for rehearing was denied by order dated March 20, 1970. The jurisdiction of this Court is invoked under 28 USC § 1254(1).

QUESTIONS PRESENTED.

1. When counsel fees are claimed on the basis of the alleged creation of a fund benefiting a class of persons, may these fees be collected from the defendant out of whose resources the alleged fund was created rather than from the class allegedly benefited?

2. If a plaintiff commences an action, denominated as a class action, seeking damages which he claims will result from a contemplated corporate transaction, and plaintiff does not institute procedures under Rule 23 of the Federal Rules of Civil Procedure, does Rule 23 prohibit defendants from consummating the transaction on terms different from those originally announced without the approval of the court and notice to all members of the alleged class?

3. When a plaintiff who was neither a purchaser nor seller of securities commences an action wherein he seeks damages alleged to result from a contemplated securities transaction, does the complaint state a cause of action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder?

STATUTES AND RULES INVOLVED.

The statutory provisions involved are Section 10(b) of the Securities Exchange Act of 1934 (15 USC § 78j(b)), Rule 10b-5 promulgated thereunder (17 CFR § 240.10b-5), and Rule 23 of the Federal Rules of Civil Procedure, all of which are printed in Appendix A hereto.

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STATEMENT OF THE CASE.

Petitioners are defendants in an action brought by a stockholder of Schenley Industries, Inc. ("Schenley"), on his own behalf and allegedly on behalf of all the holders of Schenley common stock other than Glen Alden Corporation ("Glen Alden") who held such stock on the date of the filing of the complaint. The controversy at present concerns the right of plaintiff to obtain counsel fees from petitioners.

On March 20, 1968, Glen Alden purchased from Lewis S. Rosenstiel ("Rosenstiel") and related sellers 945,126 shares of Schenley common stock for $80 per share. The agreement with Rosenstiel provided that it was the intention of the parties that Glen Alden would afford all holders of Schenley common stock an opportunity to sell their shares for a total consideration comparable to or more favorable than the price paid to Rosenstiel. In accordance with this agreement, at the time of the purchase from Rosenstiel, Glen Alden publicly announced its intention to make a tender offer to the remaining common stockholders of Schenley of $20 in cash, a 6% debenture in the principal amount of $60, and three warrants to purchase Glen Alden's common stock at $15 per share, for each share of Schenley common stock tendered.

In April, 1968, Glen Alden publicly announced a revision of the terms of the contemplated tender offer to $10 in cash and a 6% debenture in the principal amount of $100 for each Schenley share, eliminating the warrants. Neither of these contemplated offers ("the proposed tender offers") was ever made to Schenley stockholders. In August of 1968, Glen Alden publicly announced, and for the first time made, a tender offer to the common stockholders of Schenley,

consisting of $13 in cash and a 6% debenture in the principal amount of $100 for each 1.5 shares of Schenley stock.[1]

Plaintiff's initial complaint was filed on March 28, 1968; the amended complaint before the Court ("the amended complaint") was filed on July 2, 1968. The amended complaint, brought under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, alleged that the proposed tender offers as announced by Glen Alden were not equal or comparable to the $80 per share paid by Glen Alden to Rosenstiel, alleged offers already made by P. Lorillard Co. ("Lorillard") for Schenley stock, and offers which could have been obtained from other corporations. It alleged further that Glen Alden's announcement of March 20, 1968, falsely represented that Schenley's common stockholders would receive a consideration for their shares equal or comparable to that received by Rosenstiel, and omitted to state that Schenley shareholders had been deprived of an opportunity to effect a more favorable disposition of their shares to Lorillard or some other corporation.[2] The complaint requested damages and an accounting of defendants' alleged profits.

After the consummation of the tender offer, plaintiff filed a petition for counsel fees, costs and expenses, alleging that his action was now moot except for the question of counsel fees, since the offer actually made by Glen Alden had been equal or comparable to the amount paid to Rosenstiel. Plaintiff alleged further that Glen Alden had revised the proposed tender offers as the result of plaintiff's suit, and that his efforts had thus created a fund for the Schenley shareholders he allegedly represented in the amount of

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1. The tender offer was made subsequent to a three-for-two split of Schenley common stock.

2. Plaintiff's second cause of action, not relevant here, alleged that the identical conduct was in violation of common law fiduciary obligations.

$83,000,000. On this basis, plaintiff sought an award of counsel fees of $8,300,000 *from the defendants in the action.*[3]

Defendants then moved to dismiss both the complaint and the petition. The District Court granted the motion to dismiss, holding, *inter alia,* that

> (a) plaintiff could not recover counsel fees from the adverse party out of whose funds the benefit to plaintiff's class was allegedly created, but rather can recover such fees only from the persons allegedly benefited; and
>
> (b) the complaint could not have withstood a motion to dismiss, since plaintiff was not a defrauded purchaser or seller of securities as required for damage actions under Section 10(b) and Rule 10b-5.

The Court of Appeals for the Third Circuit reversed, holding that (1) plaintiff may be entitled to obtain counsel fees from defendants if the defendants flagrantly ignored Rule 23 of the Federal Rules of Civil Procedure by not obtaining court approval before making the tender offer; and (2) the complaint stated a cause of action under Section 10(b) and Rule 10b-5 since plaintiff was not required to be a defrauded purchaser or seller of securities in order to maintain an action under this Section.

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3. Plaintiff has never sought to recover fees from the Schenley shareholders he allegedly benefited, nor did he ever institute the class action procedures pursuant to Rule 23 of the Federal Rules of Civil Procedure in an effort to bring these shareholders before the Court. Plaintiff also did not seek to enjoin the offer or to require that an amount be set aside to provide for counsel fees.

REASONS FOR GRANTING THE WRIT.

A. The Decision of the Court of Appeals Permitting Respondent to Assert a Claim for Counsel Fees Against Petitioners Is in Conflict With Applicable Decisions of This Court and Courts of Appeals of Other Circuits and Presents an Important and Far-Reaching Question Which This Court Should Resolve in the Public Interest.

The present decision of the Court of Appeals, permitting a claim for counsel fees to be asserted against the adversaries in an action, is in sharp conflict with applicable decisions of this Court, as well as with decisions of the state courts and of the Courts of Appeals of other circuits. Moreover, we submit that the decision is clearly erroneous, and, if permitted to stand, will have grave impact on a wide variety of important corporate transactions.

The rule promulgated by the Court of Appeals in the present case is in direct conflict with the many decisions by this Court and by other Courts of Appeals (including the very recent decision of this Court, *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375 (1970)), holding that when a claim for counsel fees is predicated upon the contention that plaintiff has created a fund or other benefit for a class of persons, any recovery must be from the class of persons benefited, on the theory that the beneficiaries of a fund equitably should share in the expenses of its creation.

This principle was laid down by this Court in *Trustee v. Greenough*, 105 U. S. 527, 532 (1882), as follows:

> "It is a general principle that a trust estate must bear the expenses of its administration. It is also established by sufficient authority, that where one of many parties having a common interest in a trust fund, at his own expense takes proper proceedings to save it from destruction and to restore it to the purposes

of the trust, he is entitled to reimbursement, *either out of the fund itself, or by proportional contribution from those who accept the benefit of his efforts.*" (Italics added.)

This rule has been followed without deviation by this court (*Sprague v. Ticonic National Bank*, 307 U. S. 161 (1939); *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U. S. 714, 718-719 (1967); *Mills v. Electric Auto-Lite Co., supra,*) and also by the state courts and lower federal courts. See *Levine v. Bradlee*, 378 F.2d 620 (3rd Cir. 1967); *Missouri Pacific Railroad Co. v. Slayton*, 407 F.2d 1078 (8th Cir. 1969), *cert. den.*, 395 U. S. 937 (1969); *Nolte v. Hudson Nav. Co.*, 47 F.2d 166, 167 (2d Cir. 1931); *Chrysler Corporation v. Dann*, 43 Del. Ch. 252, 223 A. 2d 384, 386 (Del. Sup. Ct. 1966), in which the court said:

> "[W]hen the litigation results in benefit to all members of a class, the successful litigant is entitled to an allowance for counsel fees *to be paid from the fund or property which his efforts have created . . . .*" (Italics added.)

In accordance with this rule, it has been held that counsel fees predicated upon the creation of a fund or benefit in a representative or derivative action cannot be recovered from the adversary out of whose resources the fund has been created—irrespective of the nature of that adversary's conduct. Thus, in *Jones v. Uris Sales Corporation*, 373 F. 2d 644 (2d Cir. 1967), plaintiff in a derivative action recovered a default judgment on behalf of the corporation against a director of the corporation after flagrant and repeated violations by the defendant of certain court orders. In addition to the basic recovery, the District Court awarded plaintiff counsel fees to be paid by the director-defendant. The Court of Appeals reversed the award of counsel fees as improper, and directed that they

be paid by the benefited corporation. The court said, in language completely apposite in the present case, and directly contrary to the present holding by the Court of Appeals (373 F. 2d at 648-649):

> "[Plaintiff's] large ownership in the corporation and the direct impact of some of [the defendant's] conduct upon her investment appear to have misled the special master and the district judge into forgetting the reason for the award of such fees in a stockholder's derivative suit—that the plaintiff's efforts have conferred on the corporation a benefit for which the corporation would otherwise have had to pay itself. [citations omitted] *A defendant adjudged liable in such a suit stands no differently, as regards his obligation to pay his adversary's legal expense, than one in any other litigation; there is no more reason for his having to pay the attorneys' fees of an adverse party when a stockholder sues in the corporation's behalf than when the corporation does this itself.* This conclusion follows whether decision on this issue is governed by § 626(e) of the New York Business Corporation Law . . . or by federal procedural law." (Italics added.)

Equally pertinent and equally contrary to the ruling in the present case is the language of the Court of Appeals for the Fourth Circuit in *Ballwanz v. Jarka Corporation of Baltimore*, 382 F. 2d 433, 435 (4th Cir. 1967):

> "It is well settled, of course, that lawyers, who successfully create or preserve a fund in the custody of the court for the benefit of a class, are entitled to reasonable compensation out of the fund. . . . That principle does not extend to the recovery of legal fees from one, not a member of a mutually benefited class, who derives an incidental benefit from litigation. *Most assuredly, it does not extend to the imposition of legal*

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> *fees upon an adverse party out of whose resources the alleged fund has been created.*" (Italics added.)

See also, *Mardel Securities Inc. v. Alexandria Gazette Corporation,* 278 F. Supp. 1010, 1017-18 (E. D. Va. 1967); *Rogers v. Hill,* 34 F. Supp. 358, 366 (S. D. N. Y. 1940). See particularly, *Missouri Pacific Railroad Company v. Slayton,* 407 F. 2d 1078, 1083 (8th Cir. 1969), *cert. den.,* 395 U. S. 937 (1969), in which the court held that recovery of counsel fees in a derivative action from the corporation which did not benefit from the action went "well beyond the great weight of existing authority", and that the fees should be paid by the shareholders who did benefit from the action.

The uniform line of authority holding that counsel fees predicated upon the creation of a benefit for a class of persons are to be recovered from the persons benefited culminated in this Court's recent decision in *Mills v. Electric Auto-Lite Co., supra.* In *Mills,* the Court held that a plaintiff who had succeeded in producing a benefit to a class of stockholders in an action under the Securities Exchange Act was entitled to recover reasonable counsel fees. However, the Court made it clear that such a recovery would be allowed only if it came from the benefited class. The Court stated:

> "To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful party with the expenses but to impose them on the class that has benefited from them and that would have had to pay them had it brought the suit." (396 U. S. at 396-397).

The present decision of the Court of Appeals holds, in departure from this principle, that when a complaint allegedly on behalf of a class of stockholders is directed at a proposed corporate transaction, and the corporation subse-

quently determines to modify the terms of this proposed transaction, it may be liable for plaintiff's counsel fees if it does not seek court approval pursuant to Rule 23 of the Federal Rules of Civil Procedure before proceeding. We submit that such a rule permits and encourages a single shareholder of a corporation to paralyze corporate action, sterilize corporate negotiations, and frustrate the will and judgment of a corporation's directors and stockholders—in effect, it would not only place the shareholder on the corporation's board of directors, but also give him a veto power over corporate action.

Thus, once a contemplated transaction is announced,[4] if any shareholder of any corporation involved files a complaint, the parties may be effectively prevented by the requirement of seeking court approval from making changes in the terms of the transaction, irrespective of the financial circumstances which may develop or the myriad of factors which ordinarily influence corporate negotiations. Moreover, since court approval may be obtained only after time-consuming circularization of stockholders, the opportunity to consummate many transactions which depend upon complex considerations of timing would inevitably be lost. The net result would be to deprive the corporation's shareholders of the opportunity to receive the benefits of these transactions.[5]

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4. It is now well settled that public announcement of a contemplated transaction is required if the information would have an effect on the securities market. See *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. den.*, 394 U. S. 976 (1969); New York Stock Exchange Company Manual, Section A-2, p. A-18.

5. Indeed, the effect that such a rule would have on corporate action is demonstrated dramatically with respect to the transaction involved in the case at bar, as to which, in addition to four actions commenced by this plaintiff, five largely similar actions, all denominated as class actions, were commenced by other Schenley shareholders in three different courts after the proposed tender offer was announced.

Moreover, several actions were also brought by Glen Alden stockholders claiming that Glen Alden was paying an *excessive*

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In sum, we respectfully submit that the rule announced by the Court of Appeals would have grave consequences for the business community, and departs to such an extent from accepted principles of law, and from ordinary and accepted business practice, as to call for review by this Court.[6]

B. The Court of Appeals' Interpretation of Rule 23 of the Federal Rules of Civil Procedure Is in Conflict With the Decision of Another Court of Appeals, and Is Contrary to the Purpose of the Rule; Its Decision Has So Far Departed From the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision.

The Court of Appeals' holding that Glen Alden was required to seek court approval under Rule 23(e) of the Federal Rules of Civil Procedure before proceeding with its tender offer is directly in conflict with the decision of the Court of Appeals for the Second Circuit in *Wolf v. Barkes*, 348 F. 2d 994 (2d Cir. 1965), *cert. den.*, 382 U. S. 941 (1965), and is completely contrary to the purpose of the rule.

In the *Wolf* case, plaintiff brought a derivative action challenging the validity of certain arrangements between a corporation and its officers. Subsequently, the corporation

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amount to Schenley shareholders. Under the Court of Appeals' decision, Glen Alden, before altering the terms of the proposed offer, would also have had to obtain the approval of the three courts in which these actions were pending, and Glen Alden shareholders, as well as Schenley shareholders, would have had to have been circularized.

6. Such a rule might possibly have some justification if plaintiff had been deprived by petitioners of the opportunity to seek counsel fees from the persons he allegedly benefited. However, as the Court of Appeals found, plaintiff had ample opportunity to assert his claim for counsel fees against the monies to be paid to the Schenley shareholders before the tender offer was consummated; as the court said, ". . . he could have sought an injunction to enjoin the payment and to assert his claim against it in court." (Appendix B, p. A15). Indeed, even after consummation of the offer, plaintiff could have sought, and still can seek, to collect counsel fees from the persons he allegedly benefited.

determined to rescind the arrangements with certain of the officers in question. Plaintiff then moved for an injunction, alleging that the procedures of Rule 23 with respect to settlement had not been complied with, and that the corporation was required to obtain court approval after notice to all shareholders before any such action could be taken. Plaintiff's contention was summarized by the Court of Appeals as follows:

> "Appellant's contention is that the pendency in a federal court of a stockholder's derivative action challenging arrangements between a corporation and its officers deprives the corporation and officers of power to make any out-of-court settlement—that is, one not requiring action by the court in the derivative suit—and that once the suit has been brought, there must be notice to stockholders and court approval as provided in F. R. Civ. P. 23(c), even though the settlement itself calls for no judicial action." (348 F. 2d at 994).

The Court of Appeals explicitly rejected this contention, and held that Rule 23 was inapplicable to out-of-court transactions which did not relate to plaintiff's action and did not invoke judicial process, even if these transactions had the effect of constituting a settlement of plaintiff's claim. It pointed out that the Rule by its terms was inapplicable to out-of-court action, since "[n]o one has sought to dismiss or compromise the class suit" (348 F. 2d at 996). It noted further that the purpose of the dismissal and compromise provisions was to prevent collusive settlements with plaintiff's attorney in a derivative or representative action, and that this purpose was not served in any way by applying the rule to out-of-court conduct.

The court held that the Rule was applicable only when "the court's own process is being used to obtain a determination which, in one way or another, will bind or prejudice the class on whose behalf the suit was brought" (348

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F. 2d at 996). It noted that while that situation presented a proper subject for judicial rule-making, there was substantial doubt whether such rule-making power could legally be extended so as to affect a corporation's substantive rights by "invalidating an out-of-court settlement by a corporation simply because it was a defendant in a federal court derivative action" (348 F. 2d at 996). The court thus concluded that "the corporation's power to make its own out-of-court settlements, subject to normal shareholder redress, is not abolished by a procedural rule that does not embrace these either in its language or in its primary rationale."[7] (348 F. 2d at 997).

It is apparent that the present decision is in direct conflict with the decision of the Court of Appeals in *Wolf* on an issue of overwhelming and far-reaching importance to the corporate community. If the present decision is permitted to stand, it will transform Rule 23(e) from a procedural safeguard protecting corporations and their shareholders against collusive settlements to an affirmative weapon for the harassment of corporations, a weapon capable of producing incalculable damage and of frustrating corporate action to the detriment of all of a corporation's stockholders. It is respectfully submitted that this would be a perversion of the purpose of the Rule, and that this Court should exercise its supervisory power to correct the Court of Appeals' decision.[8]

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7. The court in *Wolf* noted that the plaintiff in that case had an adequate opportunity to protect her rights in various ways. This is also clearly true in the present case; as the Court of Appeals itself pointed out, plaintiff had ample opportunity to protect his rights by seeking an injunction to prevent the tender offer unless provision were made for the fees allegedly due him. Plaintiff can, in fact, still seek to collect his fees from the persons he allegedly benefited.

8. We suggest that this case also presents an appropriate vehicle for this Court to give badly-needed guidance on the question of whether the plaintiff or the defendant should be required to institute the class action procedures under Rule 23. At present, until such procedures are instituted, an action denominated as a class action is

C. The Decision of the Court of Appeals That Plaintiff's Complaint Stated a Cause of Action Under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) Promulgated Thereunder Is in Conflict With Applicable Decisions of the Courts of Appeals of Other Circuits.

The Court of Appeals, contrary to the District Court, held that plaintiff's complaint for damages stated a claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder even though plaintiff was not a defrauded purchaser or seller of securities.[9]

The decision of the Court of Appeals is thus in conflict with the many decisions holding that a plaintiff must be either a defrauded purchaser or a defrauded seller of securities to state a claim under these provisions. See, *e.g.*, *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.

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neither fish nor fowl; the potentially grave consequences which may flow from this procedural limbo are well illustrated by the dilemma faced by the petitioners in the instant case.

We suggest further that it would be appropriate to require a plaintiff to institute these procedures, particularly if Rule 23 is to be made applicable to out-of-court conduct, and that the Rule should not apply until a plaintiff has sought a class action determination pursuant to Rule 23(c)(1). In this manner, the plaintiff himself, by affirmative action, would be required to distinguish between a serious action seeking to redress corporate wrongs and a frivolous suit intended merely to harass the corporation and coerce a settlement. To impose this responsibility on defendants, would, we suggest, be unwarranted; in a case such as the instant case, where nine actions denominated as class actions were brought by three different plaintiffs in four different courts, the burden would be intolerable.

9. When a plaintiff seeks counsel fees in an action which has become moot prior to judicial determination, he must establish in the first instance that his complaint could have survived a motion to dismiss for failure to state a cause of action. *Chrysler Corporation v. Dann*, 43 Del. Ch. 252, 223 A. 2d 384 (Del. Sup. Ct. 1966); *Rosenthal v. Burry Biscuit Corporation*, 209 A. 2d 459 (Del. Ch. 1949); *Globus, Inc. v. Jaroff*, 279 F. Supp. 807 (S. D. N. Y. 1968); *Levine v. Bradlee*, 378 F. 2d 620, 623 (3rd Cir. 1967).

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1951), *cert. den.*, 343 U. S. 956 (1952); *Iroquois Industries v. Syracuse China Corp.*, 417 F. 2d 963 (2d Cir. 1969); *Greenstein v. Paul*, 400 F. 2d 580 (2d Cir. 1968); *Greater Iowa Corporation v. McLendon*, 378 F. 2d 783 (8th Cir. 1967); *Jachimiec v. Schenley Industries, Inc.*, No. 15027 (7th Cir. 1965), *cert. den.*, 382 U. S. 841 (1965).

Although plaintiff's complaint sought only damages, and demanded a jury trial, the Court of Appeals held that a claim for injunctive relief was "inherent in the complaint,"[10] and that the requirement that plaintiff be a defrauded purchaser or seller of securities did not apply to injunctive actions under Section 10(b). The Court of Appeals, in so holding, recognized (Appendix B, p. A24) that the courts of appeals were divided on the question of the standing to bring an injunctive action under this provision, and that its determination was in conflict with the decision by the Court of Appeals for the Eighth Circuit in *Greater Iowa Corporation v. McLendon*, 378 F. 2d 783 (8th Cir. 1967), and the decision by the Court of Appeals for the Seventh Circuit in *Jachimiec v. Schenley Industries, Inc.*, No. 15027 (7th Cir. 1965), *cert. den.*, 382 U. S. 841 (1965).

The scope of Section 10(b) and Rule 10b-5 is a question which has generated much recent controversy in the federal courts, and has become of increasing importance as actions under this section become more prevalent. It is respectfully submitted that this Court should resolve the

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10. The logical conclusion from this determination is that the requirement that plaintiff be either a defrauded purchaser or defrauded seller of securities does not apply to a complaint under Section 10(b) addressed to a contemplated future transaction, even if only damages are sought in the complaint, and the plaintiff never in fact seeks to enjoin the transaction in question. If this is the Court's ruling it is in conflict with the decision of the Court of Appeals of the Second Circuit in *Mutual Shares Corporation v. Genesco*, 384 F. 2d 540 (2d Cir. 1967), in which the Court, although upholding a claim for injunctive relief by a plaintiff who was neither a purchaser nor seller of securities, dismissed a damage claim addressed to an allegedly continuing manipulatory scheme.

conflicting decisions of the various courts of appeals on this subject, and provide guidance to the lower courts and to litigants in this important area.

CONCLUSION.

The instant case presents three important issues as to which there is a conflict of authority which should be resolved by this Court. For the reasons set forth herein, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

15 U. S. C. § 78j(b).

§ 78j. Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. June 6, 1934, c. 404, § 10, 48 Stat. 891.

17 C. F. R. § 240.10b-5.

§ 240.10b-5. Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. (Sec. 10; 48 Stat. 891; 15 U. S. C. 78j) [13 F. R. 8183, Dec. 22, 1948, as amended at 16 F. R. 7928, Aug. 11, 1951]

Federal Rules of Civil Procedure
Rule 23.

CLASS ACTIONS.

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby

making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to Be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does

not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly;

(5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. As amended Feb. 28, 1966, eff. July 1, 1966.

APPENDIX B.

Opinion of the Court of Appeals for the Third Circuit (Filed February 20, 1970).

ADAMS, *Circuit Judge*

This is an appeal from the order of the District Court for the District of Delaware dismissing the petition of plaintiff, Alexander Kahan, for counsel fees and expenses arising out of his individual and representative actions against defendants for violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 [1] promulgated thereunder and for a breach of defendants' common law fiduciary duties. These suits were based on alleged misrepresentations, manipulations and nondisclosures in connection with a tender offer. Although the underlying suit which generated the bulk of the legal expenses has been rendered moot by the action of certain of the defendants, plaintiff contends that his efforts in instituting legal proceedings against the defendants benefited the class he represented and deterred the defendants' "fraudulent scheme".

The District Court dismissed plaintiff's petition for counsel fees on the grounds that: plaintiff had not filed a meritorious damage action which could survive a motion to dismiss, because he was not a purchaser or seller and because he failed to allege reliance on the deception; plaintiff failed to establish a proper class action, or benefit to the class; and plaintiff sought counsel fees from the defendants rather than from a fund created by his efforts. [Kahan v. Rosenstiel, 300 F. Supp. 447 (D. Del. 1969)]

Because the District Court disposed of the matter on a motion to dismiss, the facts alleged in plaintiff's petition

1. 15 U. S. C. § 78j(b); 17 C. F. R. § 240.10b-5.

for counsel fees and his amended complaint in the underlying suit must be accepted as true. *See e.g.* Walker Process Equipment, Inc. v. Food Machinery and Chemical Company, 382 U. S. 172, 175 (1965); Frank Mashuda Co. v. Allegheny County, 256 F. 2d 241, 242 (3d. Cir. 1958) *aff'd* 360 U. S. 185, 2J Moore Federal Practice ¶ 12.08 (2d. ed. 1966). The essential allegations are as follows:

Plaintiff is a minority shareholder (owner of 750 shares) in Schenley Industries, a Delaware corporation. Defendants, in this proceeding and in the underlying suit, are the directors of Schenley at the time of the transaction alleged, including Lewis S. Rosenstiel, the controlling shareholder, the Dorothy H. & Lewis S. Rosenstiel Foundations alleged to be dominated and controlled by Rosenstiel and to be his "alter ego", Glen Alden Corporation, the tender offeror, and Meshulam Riklis, the controlling shareholder of Glen Alden.

In March, 1967, Schenley and P. Lorillard Company were engaged in negotiations for a merger between the two companies. As a condition of the merger, Rosenstiel, Schenley's chairman and chief executive officer, demanded a premium for his stock and the stock he controlled. Because Lorillard refused to pay the premium, negotiations terminated with Lorillard, and commenced with Glen Alden which was willing to meet Rosenstiel's terms. In March, 1968, as a result of these talks and as part of a plan by Glen Alden to acquire control of or merge with Schenley, Rosenstiel sold 945,126 shares of Schenley common stock to Glen Alden for $80 per share, making Glen Alden the controlling shareholder of Schenley. This occurred although Lorillard's proposed overall offer to every shareholder of Schenley common stock was better than the offer to be made by Glen Alden to the other Schenley shareholders, and despite the fact that other corporations were ready and willing to make better overall offers to Schenley common stockholders.

Contemporaneously with Glen Alden's purchase of Rosenstiel's shares, it was publicly announced through various financial and news media that a tender offer by Glen Alden would be made to Schenley shareholders which would be equivalent to the $80 per share paid to Rosenstiel. This offer was to consist of $20 in cash, a six percent twenty-year subordinated debenture in the principal amount of $60, and three warrants to purchase Glen Alden's common stock at $15 per share for each share of Schenley common stock.

Plaintiff concluded that the value of this proposed offer had been misrepresented in that it was not equal to the sum paid to Rosenstiel for the shares controlled by him. He filed a class action in the District Court of Delaware on behalf of all Schenley common shareholders at the time of the alleged transaction except for those involved in it, and also filed a suit in the Delaware Court of Chancery. These actions charged defendants with violating § 10(b) of the 1934 Securities Exchange Act and Rule 10b-5, and with a breach of fiduciary duties.[2] The principal charges in the suit filed in the Delaware District Court were:

(1) Defendants' representations that the originally announced offer was equal or comparable to the $80 per share paid Rosenstiel were materially false and misleading; and

(2) Defendants' representations omitted the material fact that plaintiff and each member of his class had been deprived of the opportunity to effect a more favorable disposition of their shares to Lorillard or to other corporations.

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2. Plaintiff also sued in the United States District Court for the Southern District of New York, and the New York Supreme Court. In addition to the four actions commenced by this plaintiff, five largely similar actions, all allegedly class actions, were commenced by other plaintiffs in three different courts.

Plaintiff further alleged that as a result of this legal action and the efforts of his counsel, Glen Alden publicly announced in April, 1968, it would increase its offer. The new offer included $10 in cash and a six percent twenty-year subordinated debenture in the principal amount of $100. Although this represented a $17 increase over the original offer, plaintiff contended it was still not equal to the $80 per share paid to Rosenstiel and filed an amended complaint. In August, 1968, the offer was raised to include $13 in cash and a six percent sinking fund, twenty-year subordinated debenture in the principal amount of $100 for each 1.5 shares of Schenley common stock,[3]—admittedly, three dollars more than the previous offer. The package included in the second revision was comparable to the $80 paid to Rosenstiel and to the offer made by Lorillard. Because defendant, Glen Alden, made these offers directly to the individual stockholders, plaintiff alleges that Glen Alden violated the provision of Rule 23(e) of the Federal Rules of Civil Procedure providing for formal class settlements. Plaintiff also alleges that through his efforts a fund of approximately $83,000,000 was created for the benefit of the class he represented. This sum is the difference between the value of the original offer and the final tender offer.[4]

On February 20, 1969, plaintiff filed a petition for counsel fees, costs and expenses; and the defendants promptly moved to dismiss both the complaint and the petition. Hearing was held on April 25, 1969, and on June 10th, Chief Judge Wright filed an opinion in support of his order dismissing plaintiff's petition. An order dismissing the

3. The final revised tender offer was made subsequent to a three for two stock split of the Schenley stock.

4. According to the pleadings, this is computed by multiplying the 4,150,000 shares of Schenley stock not controlled by Rosenstiel, prior to the stock split, by $20. The exact number of Schenley shares not controlled by Rosenstiel prior to the stock split was 4,180,874.

complaint as moot was entered on July 8, 1969. Plaintiff then appealed the dismissal of his petition.

Counsel fees and expenses incurred in litigation are not ordinarily recoverable in the absence of a statute or contract authorizing them. Fleischman Corp. v. Maier Brewing Company, 386 U. S. 714 (1967). There is, however, a well established exception in situations where a party has by his own effort and expense created or preserved a fund which benefits others. Mills v. Electric Auto Lite Co., Supreme Court, No. 64—October Term, 1969 (January 20, 1970); Sprague v. Ticonic National Bank, 307 U. S. 161 (1939); Trustees v. Greenough, 195 U. S. 527 (1881); 6J Moore Federal Practice ¶ 54.77[2] (2d ed. 1966). In such circumstances, it would be unjust to require one party to bear the entire expense which necessarily results in a benefit to a large class of persons. Although the type of cases contemplated under this doctrine are ordinarily class actions or shareholders' derivative suits establishing a fund in which others can participate, such actions are not essential for recovery if "a fund is for all practical purposes created for the benefit of others." Sprague v. Ticonic National Bank, 307 U. S. at 165.

In *Mills v. Electric Auto Lite Company, supra,* decided on January 29, 1970, the Supreme Court agreed with the decision of the Second Circuit in Smolowe v. Delendo Corp., 136 F. 2d 231 (2d Cir. 1943) *cert. denied,* 320 U. S. 751 (1943) that attorney's fees could be awarded in private suits brought to enforce the Securities Exchange Act.[5] Justice Harlan writing the opinion of the Court said that he could not "infer from the Securities Exchange Act of 1934 a pur-

5. The Second Circuit recognized the importance of counsel fee awards to private enforcement of the securities laws when Judge Clark said in *Smolowe v. Delendo Corp.*: "Since in many cases * * * the possibility of recovering attorney's fees will provide the sole stimulus for the enforcement of § 16(b), the allowance must not be too niggardly." 136 F. 2d at 241. *See also* Globus Inc. v. Jaroff, 279 F. Supp. 807 (S. D. N. Y. 1968).

pose to circumscribe the courts' power to grant appropriate remedies" including attorney's fees. slip op. at 15.

Mills was a suit brought by minority shareholders, both derivatively on behalf of the corporation and as representatives of the class of minority shareholders, to set aside a merger. The plaintiffs alleged that a proxy statement sent to the shareholders by the Auto Lite management to solicit votes in favor of a merger with Mergenthaler Linotype Company was misleading and in violation of § 14(a) of the Securities Exchange Act and Rule 14a-9 thereunder. The Court held *inter alia* that the officers of Auto Lite violated § 14(a) by issuing proxy solicitations which failed to disclose that the directors of Auto Lite who recommended approval of the merger were "under the control and domination" of Mergenthaler. Since the nondisclosed information was material to the shareholders, there was a violation of 14(a) even if the terms of the merger were fair. The Court said that the question of fairness was relevant to the relief plaintiffs could obtain on remand, but that the determination of fairness alone could not negate a finding of liability.

In Part IV of his opinion, Justice Harlan discussed the question of awarding counsel fees to the plaintiffs. He stated that "petitioners, who have established a violation of the securities laws by their corporation and its officials, should be reimbursed by the corporation or its survivor for the costs of establishing the violation." slip op. at 13-14. In the *Mills* opinion, Justice Harlan noted that the plaintiffs' suit conferred a benefit on all the shareholders although the ultimate question of relief was not yet decided. "[R]egardless of the relief granted, private stockholders' actions of this sort 'involve corporate therapeutics,' and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute." slip. op. at 20. (footnotes omitted).

In *Mills*, the Supreme Court clearly extended the circumstances in which the award of attorney's fees is appropriate to situations where the "suit has not yet produced, and may never produce, a monetary recovery from which the fees could be paid". The Supreme Court stated that the award of attorney's fees is not limited to circumstances in which there is a monetary fund from which fees may be paid, but extends to any situation in which the litigation "has conferred a substantial benefit on the members of an ascertainable class." slip op. at 17-18. The rationale of the Court's decision, which held the corporation responsible for the attorney's fees, was that all those who benefit from the litigation should share the costs proportionally.

In order to recover attorney's fees, it is not necessary that suit be brought to successful completion, since such a requirement might discourage prompt settlements.[6] Levine v. Bradlee, 378 F. 2d 620, 623, (3d Cir. 1967); Gilson v. Chock Full O'Nuts Corporation, 331 F. 2d 107 (2d Cir. 1964) (*en banc*); Schechtman v. Wolfson, 244 F. 2d 537, 540 (2d Cir. 1957); Globus v. Jaroff, 279 F. Supp. 807 (S. D. N. Y. 1968). Indeed, in *Mills* attorney's fees were awarded to the plaintiffs although it was not yet determined what relief if any plaintiffs could obtain.

It is necessary to determine, however, that where a suit is filed it is "meritorious" and that it is the plaintiff's effort which caused others to benefit. *Levine v. Bradlee;*

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6. In Mills, the Court was asked to decide whether plaintiffs could be reimbursed for future expenses in seeking relief, but did not decide that issue saying:

> * * * "We are urged to hold that such expenses should be reimbursed regardless of whether petitioners are ultimately successful in obtaining significant relief. However, the question of reimbursement for future expenses should be resolved in the first instance by the lower courts after the issue of relief has been litigated and a record has been established concerning the need for a further award. We express no view on the matter at this juncture." slip op. at 14n.13.

Globus v. Jaroff; Chrysler Corporation v. Dann, 43 D. Ch. 252, 223 A. 2d 384 (1966). In several cases which became moot, courts have said suits were "meritorious" if they could have survived a motion to dismiss. *See e.g., Chrysler Corporation v. Dann;*[7] Rosenthal v. Burry Biscuit Corporation, 42 D. Ch. 279; 209 A. 2d 459 (1949).

In the cases previously cited, including *Mills v. Electric Auto Lite Company,* plaintiffs were awarded counsel fees from the fund created or from the class which benefited from their action. In the present case plaintiff seeks the highly unusual relief of having counsel fees paid by an adverse party. In derivative suits when a plaintiff sues corporate officers for breach of their fiduciary duties, the corporation which benefits from the suit, not the directors charged with mismanagement, is directed to pay. *See* Jones v. Uris Sales Corp., 373 F. 2d 644 (2d Cir. 1967); *c.f.* Ballwanz v. Jarka Corp., 382 F. 2d 433, 435 (4th Cir. 1967). In *Mills,* fees were awarded from the corporation in which the plaintiff was a shareholder. "To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action," stated Justice Harlan, "is not to saddle the unsuccessful party with the expenses but to impose them on the class that has benefited from them and that would have had to pay them had it brought the suit." slip op. 20-21. In exceptional circumstances, however, where the behavior of a litigant has reflected a willful and persistent "defiance of the law", a court of equity has the power to

7. Recovery of attorneys' fees has been allowed in the Second Circuit even when suit was not commenced. In Blau v. Rayette-Faberge, Inc., 389 F. 2d 469 (2d Cir. 1968), the plaintiff shareholder hired a lawyer to investigate a violation of § 16(b) of the Securities Exchange Act. As a result of plaintiff's actions, but without suit, the corporation recovered from its officers. The court cited with approval Dottenheim v. Emerson Electric Mfg. Co., 7 F. R. D. 195 (E. D. N. Y. 1947), which said that to limit recovery of attorneys' fees to cases where suit is filed would be "penalizing efficiency and expediency". 7 F. R. D. at 197. *Cf.* Cherner v. Transitron Electronic Corp., 221 F. Supp. 55 (D. Mass. 1963).

charge an adverse party with plaintiff's counsel fees as well as court costs. *See e.g., Vaughn v. Atkinson,* 369 U. S. 527, 530-31 (1962); Hill v. Franklin County Board of Education, 390 F. 2d 583, 585 (6th Cir. 1968); Bell v. School Board of Powhatan County, Virginia, 321 F. 2d 494, 500 (4th Cir. 1963) (*en banc*); Rolox v. Atlantic Coastline Railroad Co., 186 F. 2d 473, 481 (4th Cir. 1951). Such awards, however, are clearly reserved for exceptional cases. *See* Rude v. Buchhalter, 286 U. S. 451, 459-60 (1932); Local No. 149, I. U. A. A.—A. I. W. v. American Brake Shoe Co., 298 F. 2d 212 (4th Cir. 1962) *cert. denied,* 369 U. S. 873; McClure v. Borne Chemical Co., 292 F. 2d 824, 835 (3d Cir. 1961); *In re* Swartz, 130 F. 2d 229 (7th Cir. 1942); Guardian Trust Co. v. Kansas City Southern Railroad Co., 28 F. 2d 233, 240 (8th Cir. 1928); 6J Moore, Federal Practice ¶ 54.77[2] (2d ed. 1966).

In his brief, the plaintiff in the present case relies heavily on Taussig v. Wellington Fund, Inc., 187 F. Supp. 179 (D. Del. 1960) *aff'd,* 313 F. 2d 472 (3d Cir. 1963) *cert. denied,* 374 U. S. 806 (1963). *Taussig* was a declaratory judgment action filed by minority shareholders of Wellington Fund to determine the ownership of the name "Wellington". Wellington Fund, the nominal defendant in the derivative suit, was held to have the exclusive right to use the name; Wellington Company and Wellington Company, Ltd. were enjoined from using it The District Court awarded plaintiffs attorney fees from Wellington Company and Wellington Company, Ltd. which stood the most to gain by misappropriating the "Wellington" name, stating that "[a]bsent a statutory provision, an equity court is not deprived of its inherent power to award attorney's fees to the prevailing party where the circumstances warrant", i.e. where the wrongdoers' actions "were unconscionable, fraudulent, willful, in bad faith, vexatious or exceptional." 187 F. Supp. at 222-23. In *Taussig,* the

Court found as a fact "exceptional circumstances" to warrant the imposition of attorney's fees against the defendants.

In order to place himself within the scope of these cases, plaintiff here points to defendants' conduct in settling the suit without consulting plaintiff, his counsel or the court, and thus in plaintiff's words, "brazenly ignoring Rule 23(e)." If a court ultimately decides that a plaintiff created substantial benefit for others, it could find it inequitable to deprive plaintiff of counsel fees, merely because defendants prevented the physical creation of the fund by flagrantly ignoring Rule 23.[8] In order to recover from defendants on this theory, plaintiff must show *inter alia* that he instituted a valid class action such as would bring Rule 23(e) into play, and that the defendants or certain defendants ignored the Rule. On the basis of the allegations in the petition and in the complaint there is no indication that any defendant other than Glen Alden, which made the tender offer, and possibly Riklis, Glen Alden's president, prevented the creation of the fund from which plaintiff might be entitled to counsel fees.

Defendants contend and the trial court found that plaintiff did not represent a proper class under Rule 23. Plaintiff attacks this point in two ways: first, he argues that he did in fact represent a proper class; second, he contends that the plaintiff's suit should have been treated by defendants and the court as a proper class action until a final determination to the contrary was made.

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8. Plaintiff also argued that he had an attorney's lien on the fund which the defendants could not defeat by giving the money directly to the shareholders. He cites state decisions on this point. Plaintiff's suit was filed pursuant to a federal statute and must be governed by the federal cases awarding counsel fees. 6J Moore's Federal Practice ¶ 54.[77]. It should be noted that if plaintiff believed he was entitled to a lien on the amount that Glen Alden paid to the shareholders for their stock, he could have sought an injunction to enjoin the payment and to assert his claim against it in court.

The factual allegations in plaintiff's complaint would appear to be sufficient to state a class action at this stage of the proceedings. Plaintiff alleged he represented all the shareholders of Schenley's common stock at the time of the transaction in question, except, of course, for the Rosenstiel interest. Class actions have been held to be a proper and appropriate means of enforcing Section 10(b) of the Securities Exchange Act. Green v. Wolf Corp., 406 F. 2d 291 (2d Cir. 1968) *cert. denied*, 395 U. S. 911 (1969); Harris v. Palm Springs Alpine Estates, Inc., 329 F. 2d 909 (9th Cir. 1964). Esplin v. Hirschi, 402 F. 2d 94 (10th Cir. 1968) *cert. denied*, 394 U. S. 928 (1969); Swanson v. American Consumer Industries, Inc., 415 F. 2d 1326 (7th Cir. 1969). *See also* Comment, 116 U. Pa. L. Rev. 889 (1968).

The defendants contend that this was not a class action because plaintiff did not sell his stock and cannot therefore represent those shareholders who did. In *Mills v. Electric Auto Lite*, the plaintiff who did not submit his proxy represented all the minority shareholders including those who did vote for the merger. slip op. at 12 n. 11. *See also*, Swanson v. American Consumer Industries, 415 F. 2d at 1333. Defendants also state that the class consisting of all Schenley stockholders does not include those who sold their stock pursuant to the tender offer. Plaintiff, however, claimed to represent *all* persons who owned Schenley common stock at the time Glen Alden acquired Rosenstiel's interest, not merely those who presently own Schenley common stock or those who owned it when the petition was filed. The same alleged misrepresentations and nondisclosure by the defendants were addressed to this entire group. The position of the lower court that this was not a proper class because one must be a purchaser or seller to bring a § 10(b) suit is not consistent with the remaining parts of this opinion. The determination whether there is a proper class does not depend on the existence of a cause of action. A suit may be

a proper class action, conforming to Rule 23, and still be dismissed for failure to state a cause of action. As the 10th Circuit said in *Esplin v. Hirschi, supra,* since the effectiveness of the securities laws may depend in large measure on the application of the class action device "the interests of justice require that in a doubtful case, such as was presented here when considered by the trial court, any error, if there is to be one, should be committed in favor of allowing the class action." 402 F. 2d at 106.

In the present case, it is also appropriate to follow the view taken by a number of district courts, and acknowledged by Chief Judge Wright in a ruling in Rogasner v. American-Hawaiian Steamship, Civil Action No. 3707 (Appellant's Brief, p. 33), that a suit brought as a class action should be treated as such for purposes of dismissal or compromise, until there is a full determination that the class action is not proper. Gaddis v. Wyman, 304 F. Supp. 713, 715 (S. D. N. Y. 1969); Philadelphia Electric Co. v. Anaconda American Brass Co., 42 F. R. D. 324 (E. D. Pa. 1967).

By this decision we do not indicate whether Glen Alden's revised tender offers were in fact settlement offers made in response to plaintiff's suit so as to make Rule 23(e) applicable. The causal connection between plaintiff's suit and defendant's revised offer, if any, should be established at trial.

Chief Judge Wright's primary ground for dismissing plaintiff's petition was that the underlying 10(b) complaint was not "meritorious" in that it could not have withstood a motion to dismiss.[9]

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9. The Securities Exchange Act of 1934 does not specifically provide for private enforcement. Although the Supreme Court has never ruled on the question of private actions under § 10(b), the use of such actions may be implied from J. I. Case Co. v. Borak, 377 U. S. 426 (1964), holding that there is a private right of action for enforcement of § 14a exists. *See also, Mills v. Electric Auto Lite, supra;* SEC v. National Securities, Inc., 393 U. S. 453, 467 n.9 (1969).

Section 10(b) of the Securities Exchange Act of 1934 states:

> "To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 states:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

In Conley v. Gibson, 355 U. S. 41, 45-45 (1957), the Supreme Court declared "that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of this claim which would entitle him to relief." Chief Judge Wright decided that because plaintiff did not tender his shares or rely on the alleged misrepresentations, he did

not state a claim under Section 10(b) of the Securities Exchange Act. Relying on Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (2d Cir. 1952) *cert. denied*, 343 U. S. 956 (1952), Chief Judge Wright's position was that an action under 10(b) could be maintained only by a purchaser or seller who had relied on the alleged misrepresentation or nondisclosure. In *Birnbaum*, the Second Circuit upheld the dismissal of a suit under Section 10(b) and Rule X-10B-5 brought by minority shareholders of a corporation who had not sold their stock pursuant to a tender offer. After reviewing the legislative history of Section 10(b) the Court stated that the rule "extended protection only to the defrauded purchaser or seller." 193 F. 2d at 464. The words "in connection with the purchase or sale" were thus given a narrow meaning. Because *Birnbaum* was cited numerous times for the proposition that only a defrauded purchaser or seller could bring a civil action under Section 10(b), and because many courts began to question its vitality, and to distinguish it,[10] the Second Circuit specifically reviewed

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10. The purchaser-seller requirement was liberalized by courts holding that plaintiffs who did not actually sell stock were "forced sellers", (because of a statutory merger of the company in which they held stock.) Vine v. Beneficial Finance Co., 374 F. 2d 627 (2d Cir. 1967), *cert. denied*, 389 U. S. 970 (1967); or "aborted seller's", Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965); M. L. Lee & Company v. American Cardboard & Packaging Corporation, 36 F. R. D. 27 (E. D. Pa. 1964). In Stockwell v. Reynolds & Company, 252 F. Supp. 215 (S. D. N. Y. 1965), the court held that suit under Section 10(b) could be brought by one who was induced by misrepresentations to keep his shares and later sold them at a loss. *But cf.* Coffee v. Permian Corp., — F. Supp. — (N. D. Texas, Nov. 26, 1969). An exchange of shares in connection with a merger or sale of assets has been held to be "in connection with a purchase or sale." SEC v. National Securities, Inc., 393 U. S. 453, 467-68 (1969); Swanson v. American Consumer Ind., Inc., 415 F. 2d at 1330; Dasha v. Susquehanna Corp., 380 F. 2d 262, 269 (7th Cir. 1967) *cert. denied, sub nom.* Bard v. Dasha, 389 U. S. 977 (1967). *See also*, Lowenfels, The Demise of the *Birnbaum* Doctrine: A New Era For Rule 10b-5, 54 Va. L. Rev., 268 (1968) noted by the

Birnbaum in Iroquois Industries v. Syracuse China Corp., slip op. 3777 (No. 32984) (2d Cir. Nov. 3, 1969). After doing so, the Court concluded there was "no reason to deviate from [the *Birnbaum*] rule in the present case." slip op. at 3779. In *Iroquois*, the plaintiff company was a tender offeror whose offer was successfully resisted by the target company. In both *Birnbaum* and *Iroquois*, however, the suits dismissed were damage suits. A question remained open whether injunctive relief could be obtained under Section 10(b) by one who was not a purchaser or seller and who did not rely on the misrepresentation or nondisclosed information. In Mutual Shares Corp. v. Genesco, Inc., 384 F. 2d 540 (2d Cir. 1967), the Second Circuit had held that plaintiffs who did not sell their stock in reliance on the misrepresentation of defendant could bring suit for an injunction under 10(b) although they had stated no cause of action for damages. Judge Feinberg, writing the opinion, stated that he did not "regard the fact that plaintiffs [had] not sold their stock as controlling on the claim for injunctive relief." 384 F. 2d at 546. In the *Iroquois* decision, the Court noted *Mutual Shares Corp. v. Genesco* and indicated it was not inconsistent with *Birnbaum* in permitting plaintiffs to obtain injunctive relief and thus "to aid in the enforcement of the 1934 Act."[11] slip op. at 3789.

Supreme Court in 393 U. S. at 467 n.9. In an *amicus* brief in *Iroquois* the SEC urged that the purchaser-seller rule be abandoned. This Court previously declined to resolve whether subsquent cases undermined the *Birnbaum* rule. In Pappas v. Moss, 393 F. 2d 865, 870 (3d. Cir. 1968), this Court concluded that the plaintiffs in a derivative suit had standing under 10b-5 because the corporation on whose behalf they sued had sold its own stock to its director and outsiders at prices alleged to be so far below the fair value as to amount to fraud.

11. The *Iroquois* decision tried to reconcile all the previous Second Circuit cases on the question of standing to sue under 10(b). The opinion referred to Greenstein v. Paul, 400 F. 2d 580 (2d Cir. 1968), and the language in *Greenstein* that *Birnbaum* was "still the rule at least insofar as actions for damages are concerned." 400 F. 2d

The Second Circuit considered this question more recently in Crane Co. v. Westinghouse Air Brake Company, Nos. 32569-72, slip op. 3889 (Dec. 10, 1969), which makes it clear that there is no longer a *per se* requirement that plaintiffs in a 10(b) suit be defrauded purchasers or sellers. In *Crane*, a unanimous panel, including Chief Judge Lumbard who had joined in the *Iroquois* decision, held that an action for injunctive relief could be brought by one who was not a purchaser or seller provided there was a causal connection between the alleged violation of 10b-5 and the injury suffered by the plaintiff. Judge Smith who wrote the opinion in *Crane* endorsed a broad interpretation of the Rule 10b-5 so as to effectuate the policy of the Act.

> "The purchase-sale requirement must be interpreted so that the broad design of the Exchange Act, to prevent inequitable and unfair practices on securities exchanges and over-the-counter markets, is not frustrated by the use of novel or atypical transactions. *A. T. Brod & Co. v. Perlow, supra,* 375 F. 2d at 397.
>
> 'In determining who has standing to enforce duties created by statute, a court's quest must be for what will best accomplish the purposes of the legislature.' *Electronic Specialty Co. v. International Controls Corp.,* 409 F. 2d 937, 946 (2d Cir. 1969). The purpose of Congress in enacting sections 9(a)(2) and 19(b) was to protect the investing public from manipulation and deception by the use of devices which defrauded or misled investors in securities transactions." slip op. at 3908.

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at 581. *See* Symington Wayne Corp. v. Dresser Industries, 383 F. 2d 840, 842 (2d Cir. 1967), cited in *Crane* as saying that earlier cases "expressly left undecided the question whether one who is neither a purchaser nor a seller can attack a transaction under Rule 10b-5."

Defendants in the present case interpret the *Crane* case as one involving a "forced seller" under *Vine v. Beneficial Finance,* 374 F. 2d 627 (2d Cir. 1967). *Crane* owned 32% of the stock of Westinghouse Air Brakes. When the Crane tender offer was defeated, Westinghouse Air Brake merged into American Standard, whereupon Crane sold all but 10,000 of its 740,311 shares of American Standard (which had been received in exchange for its Westinghouse shares) under threat of a divestiture action to be brought by American Standard under the antitrust laws. As indicated in the following paragraph, Judge Smith did not limit his opinion to the "forced seller" theory:

> "We find violation of both section 9(a)(2) and Rule 10b-5 and standing in Crane to raise the issue. The amendment to the Act adding section 14(e) (15) U.S.C. § 78n(e)) effective July 29, 1968, subsequent to the events here in question, should serve to resolve any doubts about standing in the tender offer cases, even where an offeror is not, as is Crane, in the position of a forced seller." slip op. at 3909.

It may be worth noting that it was not the ultimate sale of stock by Crane which caused its alleged damage. Crane claimed that the misrepresentation and manipulation by Westinghouse caused the shareholders of Westinghouse to reject Crane's tender offer, and it was this that injured Crane.

The *Crane* decision was relied on by the District Court for the Southern District of New York in Butler Aviation International, Inc. v. Comprehensive Designers, Inc., 69 Civ. 5158 (S. D. N. Y. Dec. 12, 1969). The Court in *Butler* granted plaintiff's motion for a preliminary injunction enjoining defendant, Comprehensive Designers, Inc., from consummating an outstanding tender offer. *Butler* was

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the target corporation of the tender offer and is alleged violations of Rules 10b-5, 10b-6 and 13d-1 by the defendant. Judge Cannella stated: "[I]t is not required under Rule 10b-5 that plaintiff be a buyer or seller of stock as those terms are normally understood. The 'phrase in connection with the purchase or sale of any security' was intended by Congress to mean only 'that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities.' [SEC v. Texas Gulf Sulfur Co., 401 F. 2d 833 at 860 (2d Cir. 1968)] See Crane Co. v. Westinghouse Air Brake Co."

The Second Circuit affirmed the decision in *Butler,* but declined to pass on the question of standing under Rule 10b saying, "Inasmuch as we agree that standing exists under § 14(e), * * * we need not pass on standing under Rule 10b-5. But cf. *General Time Corp. v. Talley Industries, Inc.,* 403 F. 2d 159, 164 (2d Cir. 1968), *cert. denied,* 393 U. S. 1026 (1969); *Crane Co. v. Westinghouse Air Brake Co.,* slip op. 3889, 3905-09 (2d Cir. Dec. 19, 1969)." Butler Aviation International, Inc. v. Comprehensive Designers, Inc., slip op. 933, 935 n.1. (No. 34387, 2d Cir. Jan. 8, 1970).

In General Time Corp. v. Talley Industries, supra, referred to by the Second Circuit in *Butler,* Judge Friendly said: "[W]e do not wish to place our approval on a holding that under no circumstances can an issuer have standing to seek an injunction. There are many practical advantages, well summarized in a note, Private Enforcement under Rule 10b-5: An Injunction for the Corporate Issuer?, 115 U. Pa. L. Rev. 618, 628-29 (1967), in allowing a corporation in certain cases to enjoin manipulation of its stock. * * * While we leave that point open, it may be useful to say that we do

not consider Birnbaum v. Newport Steel Corp. * * * to have ruled out such a suit despite phrases which if taken out of context might seem to support such a view." 403 F. 2d at 164.[12]

The reference to the *Talley* and *Crane* cases by Judge Friendly in *Butler Aviation* indicates that the *Iroquois* decision does not limit standing for injunctive relief to purchasers or sellers.

The present case represents the first time this Circuit has addressed itself to the question whether Section 10(b) may be enforced by a private party who is neither a purchaser nor seller. The Circuits which have decided the issue are divided. The Seventh and Eighth Circuits require that plaintiffs be purchasers or sellers even where injunctive relief is sought. Greater Iowa Corporation v. McLendon, 378 F. 2d 783 (8th Cir. 1967) (following *Birnbaum*); Jachemec v. Schenley Industries, Inc., No. 15024 (7th Cir. 1965) *cert. denied,* 382 U. S. 841 (1965). The Second Circuit has construed the statute more broadly at least where an injunction is sought. The Sixth Circuit has also indicated that in a suit for injunctive relief the requirements may be liberalized. In Britt v. The Cyril Bath Co., 417 F. 2d 433, 436 (6th Cir. 1969), that court stated that in a suit under § 10(b), the necessary causal connection between the fraud alleged and the resultant purchase or sale of a security might be relaxed.

A broad view of the requirements for stating a claim for injunctive relief is particularly appropriate. In SEC v. Capital Gains Research Bureau, Inc., 375 U. S. 180 at 193 (1963), the Supreme Court said, "It is not necessary in a

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12. *See also,* Electronic Specialty Co. v. International Controls Corp., 409 F. 2d 937 (2d Cir. 1969); and Moore v. Great America, 274 F. Supp. 490 (N. D. Ohio 1964), holding that the target corporation of a tender offer has standing to sue for injunctive relief against defendants' violations of 10(b).

suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages."[13]

Neither the language of § 10(b) and Rule 10b-5 nor the policy they were designed to effectuate mandate adherence to a strict purchaser-seller requirement so as to preclude suits for relief if a plaintiff can establish a causal connection between the violations alleged and plaintiff's loss. We agree with the Second Circuit in *Crane* that a strict interpretation of the Securities Exchange Act is not warranted under the circumstances present here. The Act was designed to eliminate deceptive and unfair practices in security trading and to protect the public from inaccurate, incomplete and misleading information. The thrust of the Act and the decisions interpreting it is to give the investing public the opportunity to make knowing and intelligent decisions regarding the purchase or sale of securities. A suit which seeks to enjoin deceptive practices which if continued would lead to completed purchases or sales that give use to a cause of action under § 10(b) is not inconsistent with this policy and will in fact promote free and open public securities markets.

The District Court found plaintiff's pleadings deficient in that they failed to allege reliance on the defendants' misrepresentation. Proof of reliance is not an independent element which must be alleged to establish a cause of action. In the recent *Mills* case, the Supreme Court ruled that reliance on false or misleading proxy statements is not required in order to set forth a cause of action under § 14(a) of the Securities Exchange Act. Judge Harlan stated:

> "Where the misstatement or omission in a proxy statement has been shown to be 'material,' as it was found to be here, that determination itself indubitably

13. In Tcherepnin v. Knight, 389 U. S. 332, 336 (1967) the Supreme Court also said that the Security Exchange Act is remedial legislation and as such should be construed broadly.

embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote. This requirement that the defect have a significant propensity to affect the voting process is found in the express terms of Rule 14a-9, and it adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a)." slip op. at 8.

A further reason for the Supreme Court's decision was that "Proof of actual reliance by thousands of individuals would * * * not be feasible * * * and reliance on the *nondisclosure* of a fact is a particularly difficult matter to define or prove * * *." slip op. at 6 n. 5.

Since Rule 10b-5 also prohibits only misrepresentations which are "material", the reasoning of the Supreme Court in *Mills* applies with equal force to suits brought for violation of that Rule. This is in accord with the view of the Second and Sixth Circuits in *Crane Co. v. Westinghouse Air Brake Co.*, slip op. at 3995 and *Britt v. The Cyril Bath Co.*, 417 F. 2d at 436.

Defendants contend that even if a more liberal interpretation of the statute is appropriate for injunctive relief the plaintiff here failed to request such relief and hence the complaint may not be so construed. Plaintiff's complaint does not specifically ask for equitable relief; it contains only the general request for "further relief as may be just." Nonetheless, under Rule 54(c) of the Federal Rules of Civil Procedure, a court may have awarded any relief indicated under the circumstances. *See* United States v. Maryland Casualty Company, 384 F. 2d 303, 304 (2d Cir. 1967); Arley

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v. United Pacific Insurance Company, 379 F. 2d 183, 187 (9th Cir. 1969); Whittaker v. Wall, 226 F. 2d 868, 872 (8th Cir. 1955); Fanchon & Marco, Inc. v. Paramount Pictures Inc., 202 F. 2d 731, 734 (2d Cir. 1953).[14] Plaintiff's 10(b) suit would not have been dismissed even though the complaint did not request injunctive relief, if a cause of action for injunctive relief were in fact inherent in the complaint.

Plaintiff has set forth sufficient allegations of misrepresentations, manipulations and nondisclosures of material facts "in connection with the sale or purchase of securities" so as to entitle him to the opportunity to proving a violation of the Act. If the allegations of the complaint are taken in the light strongest for the plaintiff, as we are obligated to do on a motion to dismiss, then it is conceivable that plaintiff's pleading has alleged such misconduct by the defendants. Of course, nothing in this opinion should be construed as suggesting what in fact actually did occur.

In consideration of the foregoing, it is our view that plaintiff's pleadings state a cause of action which may be the basis for an award of counsel fees, and therefore the order dismissing his petition will be reversed. The case will be remanded to the district court where plaintiff has the burden of proving the allegations set forth in his complaint and petition.[15] If the trial judge is satisfied that plaintiff has discharged this burden, he will then have the

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14. In Asphaltic Enterprises, Inc. v. Baldwin-Lima-Hamilton Corp., 39 F. R. D. 574, 576 (E. D. Pa. 1966), Judge John Lord stated that "it is well established that the prayer for relief does not determine whether the plaintiff has stated a cause of action."

15. Certain defendants contend that plaintiff has no cause of action against them because jurisdiction over them was obtained by sequestration which is limited, under Wrightman v. San Francisco Bay Toll Budget Co., 16 Del. Ch. 200; 142 A. 783 (1928), to cases where a money decree is sought. Plaintiff, however, claims that defendants waived their right to contest jurisdiction. The trial court has not passed on this point, and will have an opportunity to do so on remand.

discretion to award plaintiff counsel fees in such amount as he determines are appropriate under the circumstances of the case.[16]

16. Plaintiff's petition for counsel fees requests 10% of the $83,000,000 fund which he contends he created. The district court is, of course, not bound to award this amount, but instead must determine the actual benefit which plaintiff created for the other Schenley shareholders. Furthermore, the sum for which plaintiff is entitled to reimbursement does not hinge solely on the benefit plaintiff is successful in recovering. *See*, Mills v. Electric Auto Lite, *supra*, Angoff v. Goldfine, 270 F. 2d 185, 188-89 (1st Cir. 1959); Powell v. Pennsylvania Railroad Co., 267 F. 2d 241, 245 (3d Cir. 1959). The district court should also consider the amount of time and effort expended by the plaintiff.

Opinion of the Court of Appeals for the Third Circuit Sur Petition for Rehearing (Filed March 20, 1970).

PER CURIAM

In the Petition for Rehearing, defendants other than Glen Alden and Riklis ask that the 1969 District Court order be affirmed as to them in view of the statements in the first full paragraph on page 10 of the slip opinion. We believe that it is a more orderly procedure for the District Court to consider such a contention.

APPENDIX C.

Judgment of the Court of Appeals for the Third Circuit.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 18120

ALEXANDER KAHAN; ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED,
Appellant

v.

LEWIS ROSENSTIEL, DOROTHY H. AND LEWIS ROSENSTIEL FOUNDATION, R. G. SMITH, E. R. DEUTSCHE, M. B. HOPKINS, D. D. BUSCHER, H. S. FELDMAN, SYLVAN OESTREICHER, J. L. MORRIS, THEODORE GOMMI, D. A. CHERNOW, W. E. DEVEREAUX, BERNARD GOLDBERG, G. D. KUHN, L. B. NICHOLS, JOHN MACKIE, THEODORE C. WIEHE, MESHULAM RIKLIS AND GLEN ALDEN CORPORATION.

(D. C. Civil Action No. 3509)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE.

Present: McLAUGHLIN, FREEDMAN and ADAMS,
Circuit Judges.

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the District of Delaware and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed June 30, 1969, which dismissed plaintiff's petition for costs, expenses and counsel fees, be, and the same is hereby reversed and the cause remanded for further proceedings consistent with the opinion of this Court. Costs taxed in favor of appellant.

ATTEST:

THOMAS F. QUINN,
Clerk.

February 20, 1970.

APPENDIX D.

Opinion of the United States District Court for the District of Delaware.

WRIGHT, *Chief Judge.*

The Court has before it the petition of plaintiff, Alexander Kahan, for costs, expenses, and counsel fees arising out of plaintiff's individual and representative action for damages under § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b-5 promulgated thereunder. Plaintiff's petition assumes an unusual cast, however, because the underlying damage action which generated plaintiff's legal expenses has been rendered moot by unilateral action of certain defendants. Plaintiff is thus left without a judgment or a settlement but only with the claim that defendants' dispositive action was prompted solely by plaintiff's diligent prosecution of the lawsuit. It is on this basis that plaintiff seeks compensation for his efforts in bringing about a result satisfactory to his class. Notwithstanding the mootness of the original damage claim, plaintiff's petition will be treated as a cause of action ancillary to that claim, as to which the Court admittedly had jurisdiction.[1] See Globus, Inc. v. Jaroff, 279 F. Supp. 807, 809 (S. D. N. Y. 1968).

The background of this litigation may be set forth briefly. The Amended Complaint asserts that plaintiff is a minority stockholder of Schenley Industries, Inc. (Schen-

1. Jurisdiction over the subject matter of plaintiff's action was based on § 27 of the Securities Exchange Act, 15 U. S. C. § 78aa; jurisdiction over the persons of all defendants except Lewis Rosenstiel was obtained by voluntary submission to the Court's jurisdiction and waiver of all defects in service of process. Jurisdiction over the person of Lewis Rosenstiel was never acquired and he is not now before the Court.

ley). In March, 1967, Schenley engaged in negotiations with P. Lorillard Co. (Lorillard) directed at developing a plan for merging the two companies. After some progress, negotiations were terminated when Lorillard refused to pay the premium allegedly demanded by Lewis Rosenstiel for his substantial ownership interest in Schenley. Subsequently, merger negotiations commenced between Schenley and Glen Alden Corporation (Glen Alden) and in March, 1968, Rosenstiel agreed to sell his interest in Schenley to Glen Alden for $80 per share. At the time the terms of this purchase were announced, Glen Alden stated publicly that an offer would be made to all Schenley common stockholders (including plaintiff) for the purchase of their shares. According to the statement, the proposed offer would constist of a package of cash, debentures, and warrants, a package which Glen Alden asserted was equivalent to the $80 per share paid to Rosenstiel.

On March 28, 1968, shortly after the proposed offer was announced but prior to any actual tender offer, plaintiff commenced an action in this Court [2] against Glen Alden and various individual defendants, most of whom were directors of Schenley, alleging, first, that defendants had misrepresented the true value of the proposed offer and, secondly, that defendants had acted to deprive Schenley stockholders of a more favorable merger with Lorillard. Plaintiff's action was brought on his own behalf and on behalf of the class alleged to consist of all holders of Schenley common stock. The Complaint contained two counts, the first a federal claim based on the violation of § 10b and Rule 10b-5, the second a pendent state claim based on breach of fiduciary obligations.

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2. Plaintiff also commenced similar actions in the Delaware Chancery Court, the Supreme Court of the State of New York, and the District Court for the Southern District of New York.

Not long after plaintiff brought his action in this Court, Glen Alden announced a revision of its proposed tender offer and again asserted that the new terms would be equivalent to Rosenstiel's $80 per share.[3] The revision was made without consulting plaintiff and without plaintiff's approval. Plaintiff remained dissatisfied with the proposed terms and simply amended his complaint to take account of the new proposal.

On August 9, 1968, Glen Alden again revised the terms of its offer and finally made an actual tender offer to Schenley stockholders. The second revision, though executed once more without consulting plaintiff, met plaintiff's approval[4] and plaintiff now concedes that the actual tender offer was made on terms equivalent to Rosenstiel's $80 per share.

Plaintiff no longer presses the damage claims before this Court, conceding that the actual tender offer has made them moot. However, plaintiff asserts by way of petition that, but for his diligence in prosecuting these claims, no revisions would have been made and Schenley stockholders would have suffered damage by virtue of defendants' allegedly fradulent course of conduct. Thus, plaintiff argues, he has, by his action, created a fund of $20 per share of Schenley common or $83,000,000 out of which he is entitled to recover costs, expenses, and counsel fees. Accordingly, plaintiff now seeks from defendants the sum of $8,300,000—10% of the fund—for those items.

The law is well-settled that the success of a claim for attorney's fees[5] depends, in the first instance, on the suc-

3. Plaintiff alleges that the revision represented a $17 per share increase over the original proposed offer.

4. Plaintiff alleges that the second revision represented a $3 per share increase over the first revision or a $20 per share increase over the original proposed offer.

5. Under the circumstances of this case, factors governing award of costs and expenses do not, in the Court's estimation, vary sufficiently from those governing award of attorney's fees to warrant

cess or likelihood of success of the underlying lawsuit. Levine v. Bradlee, 378 F. 2d 620, 623 (3rd Cir. 1967); Globus, Inc. v. Jaroff, supra at 809; Chrysler Corp. v. Dann, 223 A. 2d 384, 386 (Del. Sup. Ct. 1966). While there is no requirement that one seeking counsel fees first win a judgment, Globus, Inc. v. Jaroff, supra at 809, the law does require some demonstration of the "meritorious quality" of the underlying action. Levine v. Bradlee, supra at 623. In situations like the instant case where the underlying suit has been settled or rendered moot, a demonstration that the basic action could have withstood a motion to dismiss on the pleadings at the time the action was filed is sufficient to establish its meritorious quality. Chrysler Corp. v. Dann, supra at 387. And, conversely, failure to demonstrate that the underlying action could have survived such a motion to dismiss necessitates dismissal of the fee petition. Accordingly, unless it appears that plaintiff's damage action could have withstood a motion to dismiss on the pleadings at the time the action was filed, plaintiff's petition for legal fees must be dismissed.

After careful examination of the pleadings filed in plaintiff's damage action, the Court is of the opinion that neither plaintiff's original complaint nor his amended complaint could have survived an appropriate motion to dismiss. Even accepting as true every allegation of the complaints, both pleadings are colored by two fatal defects; namely, failure to allege that plaintiff or the members of his class were defrauded purchases or sellers and failure to allege or indicate reliance on the deceptions charged to defendants.

The absence of all allegation that plaintiff or the members of his class were defrauded purchasers or sellers of

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separate treatment. Henceforth, the Court will refer to plaintiff's petition as one for attorney's fees or legal fees, intending thereby to include all elements of compensation sought by the plaintiff.

stock goes to the very heart of § 10(b) and Rule 10b-5 upon which plaintiff's principal claims are based.[6] While the language of Rule 10b-5 outlawing deceptive practices performed "in connection with the purchase or sale of any security" is general, the law has long been clear that:

> ". . . [§ 10(b)] was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and . . . Rule X-10B-5 extended protection only to the defrauded purchaser or seller." Birnbaum v. Newport Steel Corp., 193 F. 2d 461, 464 (2d Cir. 1951), cert. den. 343 U. S. 956 (1952).

The Birnbaum rule requiring that the plaintiff in a Rule 10b-5 damage action be a defrauded seller or purchaser of stock still retains its vitality. See Greenstein v. Paul, 400 F. 2d 580, 581 (2d Cir. 1968); Christophides v. Porco, 289 F. Supp. 403, 406, 408 (S. D. N. Y. 1968); Mutual Shares Corp. v. Genesco, Inc., 384 F. 2d 540 (2d Cir. 1967).[7] Notwithstanding the vitality of the Birnbaum rule, plaintiff has provided in his pleadings no basis upon which the Court could conclude that plaintiff or the members of his

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6. It is true, of course, that the second count in each complaint is based on a state cause of action for breach of fiduciary obligations. However, jurisdiction for that count is pendent and dismissal of plaintiff's federal claims automatically requires dismissal of the pendent claims. United Mine Workers v. Gibbs, 383 U. S. 715, 725 (1966). In light of the result reached by the Court, no further mention will be made of the pendent claims.

7. Entel v. Allan, 270 F. Supp. 60, 70 (S. D. N. Y. 1967), which anticipates a change in the Birnbaum rule, is not authority to the contrary in light of Greenstein v. Paul, supra at 581. In addition, plaintiff's reliance on Pappas v. Moss, 393 F. 2d 865 (3rd Cir. 1968) as a negation of Birnbaum is misplaced since plaintiff there, while himself a non-seller, nonetheless represented derivatively a corporation which was admittedly a defrauded seller. Here, there is no derivative claim.

class were sellers or purchasers within the meaning of the law. Since both complaints were drawn prior to Glen Alden's actual tender offer, it is clear that no Schenley stock was sold or purchased pursuant to that offer. And, plaintiff's definition of the class as "holders of the common stock of Schenley" gives fair indication that no class member had yet changed his position. Finally, allegations to the effect that plaintiff and the members of his class could have sold their stock to Lorillard are to no avail since "aborted sellers" are still not sellers within the purview of Rule 10b-5. Keers & Co. v. American Steel & Pump Corp., 234 F. Supp. 201, 203 (S. D. N. Y. 1964).

Plaintiff's pleadings suffer in addition from the absence of any allegations that would indicate reliance on the deceptions charged to defendants. It is well-established that reliance is a required element of a meritorious Rule 10b-5 claim. See Mutual Shares Corp. v. Genesco, Inc., supra at 547; Rogen v. Ilikon Corp., 361 F. 2d 260, 266-267 (1st Cir. 1966); List v. Fashion Park Inc., 340 F. 2d 457, 462, 463 (2d Cir. 1965), cert. den. 382 U. S. 811 (1965).[8] However, the implication of the pleadings is that neither plaintiff nor any member of his class had yet sold his stock or changed his position in response to defendants' allegedly deceptive actions—an implication borne out by plaintiff's expresssions of satisfaction with the ultimate tender offer

8. Vine v. Beneficial Finance Co., 374 F. 2d 627 (2d Cir. 1967) cert. den. 389 U. S. 970 (1967), is not authority to the contrary. Indeed, the Court there specifically distinguished the fact situation in Vine (short-form merger or forced sale) from those in List and Rogen:

> "Whatever need there may be to show reliance in other situations, see List v. Fashion Park, Inc. . . ., Rogen v. Ilikon Corp., . . . we regard it as unnecessary in the limited instance when no volitional act is required and the result of a forced sale is exactly that intended by the wrongdoer." 374 F. 2d at 635.

The instant case is not a case where no volitional act is required and Vine is clearly not applicable.

and his discontinuance of the damage claims. All of these circumstances surely run counter to the most basic notion of damage by deception.

In light of the two defects discussed, the Court need not examine the "merits" of plaintiff's specific charges of wrongdoing and misrepresentation. It may well be that plaintiff has stated grounds which would have warranted relief in a state court. Nonetheless, plaintiff has failed to establish the basic elements of a meritorious federal claim and thus his pleadings and his petition for costs and fees must fail in this Court.

While the Court's conclusion with regard to plaintiff's underlying claim by itself requires dismissal of plaintiff's fee petition, the Court makes the following observations about the sufficiency of the petition itself:

It has long been a principle of law that:

> ". . . lawyers, who successfully create or preserve a fund in the custody of the Court for the benefit of a class, are entitled to reasonable compensation out of the fund. . . . That principle does not extend to the recovery of legal fees from one, not a member of a mutually benefited class, who derives an incidental benefit from litigation. Most asssuredly, it does not extend to the imposition of legal fees upon an adverse party out of whose resources the alleged fund has been created." Ballwanz v. Jarka Corp. of Baltimore, 382 F .2d 433, 435 (4th Cir. 1967).

See also Trustees v. Greenough, 105 U. S. 827, 832-33 (1882); Jones v. Uris Sales Corp., 373 F. 2d 644, 648-49 (2d Cir. 1967).

Plaintiff here purports to be seeking legal fees from a fund alleged to have been created by his efforts. How-

ever, plaintiff fails in a number of ways to meet the essential elements of the law governing his claim. In the first place, plaintiff's fee petition is directed against the defendants in the underlying damage action, including defendant Glen Alden. Thus, plaintiff is seeking legal fees from "an adverse party out of whose resources the alleged fund has been created" and from parties in no way benefited by the creation of the fund. In the second place, plaintiff's claim against defendants is not in fact a claim against the $83,000,000 fund identified by plaintiff, since any judgment against defendants for fees would in no way affect the obligation of certain defendants to pay the full terms of the tender offer for all shares tendered. Thus, Glen Alden could pay the entire $83,000,000 to Schenley stockholders and still remain fully bound by the judgment for fees.

Finally and fundamentally, plaintiff has failed to establish the existence of a fund. For legal purposes, at least, a "fund" is defined as the measurable financial benefit conferred upon a specified group of persons possessing a common cause of action (class) by the efforts of one or more members of that group. In the instant case, plaintiff has failed to establish either the existence of a proper class or the existence of any measurable financial benefit. As to the "class," plaintiff asserts that he is a member of and represents the "class" comprised of all present Schenley common stockholders.[9] However, as the Court has explained above, that group of persons, consisting as it does of stockholders who are neither purchasers nor sellers of stock, is not a class with a valid cause of action within the purview of § 10(b) and Rule 10b-5. As to the financial benefit, no stockholder can be said to have

9. No attempt has been made by plaintiff to seek a determination that his "class" is a proper one within the meaning of Rule 23, F. R. Civ. P.

benefited from an increase in the terms of a tender offer until that stockholder has in fact accepted the offer and sold his stock. Plaintiff's "class" of Schenley stockholders have not, by very definition, sold their stock. Accordingly, plaintiff cannot claim to have conferred a measurable benefit on them or to have created a "fund" with a definite dollar value.

For the foregoing reasons, plaintiff's petition for costs, expenses, and attorney's fees is dismissed. Submit order in accordance herewith.

Wilmington, Delaware
June 10, 1969